



A MISCELLANY OF GAAR UPDATES

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Tax for the **Owner-Manager**

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This article presents a selection of noteworthy updates relating to the amended general anti-avoidance rule (GAAR) that may be of interest to practitioners. Specifically, this article will discuss (1) important updates to CRA administrative guidance regarding GAAR that were presented at the APFF round table on October 10, 2024 (“the APFF round table”); (2) a new CRA web page on GAAR that launched in late December 2024; and (3) Quebec’s listing of transactions involving stock dividends as “determined transactions” and the implications that this listing may have for the application of GAAR to stock dividend freezes generally.

APFF Round Table GAAR Updates

In questions 13, 16, and 18 of the APFF round table the CRA made three important statements regarding GAAR.

Question 13

The CRA confirmed its position in document no. 2012-0456221R3, where it had opined, among other things, that GAAR would not apply to a post mortem transaction designed to mitigate the possible double taxation that might arise on the death of the beneficiary of a spousal trust. The post mortem planning discussed in the example uses a windup under subsection 69(5) to avoid the application of the loss denial rule in subsection 40(3.6) that might otherwise apply.

Question 16

In question 16, the CRA responded to three questions regarding the new GAAR. It stated that it was unable to provide examples of planning that were not, in its view, subject to the previous version of GAAR but would be subject to the recently amended version. The agency highlighted a recent technical interpretation (no. 2024-100825117, February 28, 2024) (“the planning TI”) in which it stated that it was generally of the view that the positions taken in *Information Circular IC88-2* and *Information Circular IC88-2, supplement 1* should remain unchanged under the amended GAAR. Citing technical interpretation no. 2023-098794117 (February 29, 2024), the CRA (1) confirmed that it would continue to issue favourable rulings on post mortem pipelines that met its accepted parameters; and (2) cautioned that rulings would not be provided either for surplus-stripping plans, such as the example in the Department of Finance’s August 4, 2023 technical notes, that describe corporate surplus-stripping transactions carried out by an individual (referred to as “Jane” in the example), or for similar plans in which an individual shareholder proposed to

undertake non-arm's-length transactions the principal purpose of which is to create adjusted cost base to be used to extract retained earnings. The CRA also referenced technical interpretation no. 2024-1016011E5 (April 29, 2024), which addressed transactions aimed at crystallizing capital gains prior to June 25, 2024.

Question 18

The FCA's holding in *Foix v. Canada* (2023 FCA 38) deals with the application of subsection 84(2) to a hybrid asset/share sale transaction. The CRA stated that the FCA's comments in *Foix* have a much broader scope and are not limited to facts identical to those in *Foix*. The CRA also reiterated its position that it set out in question 2 of the 2002 APFF round table—namely, that it would apply GAAR to surplus-stripping transactions such as those undertaken in *McNicol et al. v. The Queen* (97 DTC 11 (TCC)) and *RMM Canadian Enterprises Inc. et al. v. The Queen* (97 DTC 302 (TCC)), but not to transactions whose facts were identical to those in *Geransky v. The Queen* (2001 DTC 243 (TCC)).

CRA GAAR Web Page

In late December of 2024, the CRA launched a new [web page](#) discussing GAAR. The page contains general statements on how GAAR works and some commentary on the internal CRA procedures governing how it is administered.

The website also includes a non-exhaustive listing of transactions that the CRA considers subject to GAAR. The listed transactions currently fall into three categories: (1) surplus stripping, (2) the creation of artificial capital losses, and (3) planning related to discretionary trusts that is designed to avoid the application of the 21-year rule. The website provides three examples of surplus stripping, one example relating to the creation of artificial losses (a “value shift”), and two examples relating to planning designed to avoid the application of the 21-year rule for trusts (this last category includes transactions that are currently also “notifiable transactions”; see NT-2023-02). We will discuss the surplus-stripping examples in more detail below. (The other categories, though beyond the scope of this article, are also worthy of review.)

Surplus-Stripping Transactions

The CRA defines surplus-stripping transactions as transactions that “strip corporate surplus in a manner that defeats the object, spirit and purpose of sections 84, 84.1, 212.1 and subsection 89(1).”

This first example of a surplus strip involves a situation in which an individual holds shares in a corporation (“Corpco”) with high ACB (because the capital gains exemption was claimed) but low paid-up capital (PUC). A subsidiary transfers property with significant ACB to Corpco in exchange for shares of the same class as those held by the individual. Because of PUC averaging, this results in a significant increase in the legal stated capital of the shares held by the individual. This transaction allows the individual to access internal funds of the corporation by using the PUC created by the asset sale that would have otherwise been blocked by the application of section 84.1.

In the second example, a corporation redeems individually held preferred shares with high ACB (derived from the claiming of the lifetime capital gains exemption) but low PUC. The redemption triggers a deemed dividend and a capital loss. Because the taxpayer is affiliated with the corporation and held common shares at the time of the redemption, the denied capital loss is added to the ACB of the common shares. The common shares are then sold to a new holding corporation for preferred shares with both high ACB and high PUC. These preferred shares can then

be redeemed without any tax consequences.

The third example describes transactions that are similar to those in *Copthorne* (2011 SCC 63). The example describes transactions whereby a parent corporation and its subsidiary become “sister” companies and are then amalgamated to preserve the PUC that would have been lost on a vertical amalgamation.

The CRA did not include in its listing of surplus-stripping transactions the “Jane” example from the Department of Finance’s technical notes to Bill C-59. In these technical notes, the Department of Finance had cited the “Jane” example as lacking economic substance but provided no opinion on the question of abuse.

Other Noteworthy Website Commentary

The GAAR website also provides some limited commentary with respect to the application of the normal reassessment period and “gross negligence” penalties under subsection 163(2). The commentary does not comment on the extended reassessment period that was enacted as part of Bill C-59 for undisclosed transactions subject to GAAR.

The website states that the “[t]he [GAAR] penalty applies to a transaction only if the transaction or the series that includes the transaction was not disclosed to the Minister of National Revenue.” The website also notes that the exception to the penalty under subsection 245(5.2) (“the GAAR penalty exception”) is intended to be “a narrow rule that may apply in circumstances where a taxpayer entered into a transaction reasonably relying upon the current state of the case law and administrative guidance from the Minister of National Revenue.”

We note that this comment seems somewhat broader than the language in the GAAR penalty exception itself, which requires that a transaction or series of transactions be “identical or almost identical to a transaction or series that was the subject of (a) published administrative guidance or statements made by the Minister or another relevant governmental authority; or (b) one or more court decisions.” It is unclear whether this difference in phrasing reflects the CRA’s adoption of a more lenient administrative approach to the penalty or whether the website is simply worded differently from the statute so as to ensure readability.

Stock Dividends and GAAR

In example 10 of IC88-2, the CRA concluded that an estate freeze would not be subject to GAAR. However, that conclusion was subject to certain conditions. The examples cited by the CRA as not being subject to GAAR use either section 85 or section 86 to implement the freeze. IC88-2 and IC88-2, supplement 1 did not consider the use of stock dividends to undertake the freezes, and no court has ruled on whether an estate freeze implemented in this way is subject to GAAR. It is noteworthy that on May 29, 2024, transactions that involve the avoidance of the deemed interest rule under section 462.12 of the Taxation Act (Quebec) (a provision that is the Quebec equivalent of the corporate attribution rule in subsection 74.4(2) of the ITA) by means of a stock dividend were added to the list of “determined transactions” (the Quebec equivalent of “notifiable transactions” under section 237.4 of the ITA). A “determined transaction” listing in Quebec is not indicative of CRA views, nor does it indicate that a court will find such planning subject to GAAR. However, the listing may indicate that such transactions carry a degree of risk that practitioners may not have previously been aware of.

Conclusion

CRA updates, such as those provided at the APFF conference and via the new GAAR website, are welcome. However, it is important that such guidance be comprehensive, easily accessible, and clearly set out the CRA's views in a manner that minimizes uncertainty. In our view, consolidating all CRA commentary in one place would be a welcome development. One hopes that, with time, the CRA website will become more comprehensive and will consolidate all CRA GAAR commentary.

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